SOUTH AFRICAN RESERVE BANK
Prudential Authority

Comments on Draft 2 of the 5th set of the proposed amendments to the Regulations relating to Banks

Comments received from industry bilaterally and via the Banking Association South Africa

Introduction

1. On 21 September 2023, the Prudential Authority issued for public consultation draft 2 of the 5th set of proposed amendments to the Regulations relating to Banks (the Regulations) and the respective documents related thereto:
   a. informing all interested persons to take note of the proposed amendments to the Regulations, with the implementation date of 1 July 2025.
   b. inviting all interested persons to submit their comments on the proposed amendments to the Regulations to the PA no later than 25 November 2023.
2. Comments were received from industry bilaterally and through the Banking Association South Africa.
3. Some of the comments received on draft 2 of the 5th set of proposed amendments to the Regulations were associated with the Equity Risk in the Banking Book framework, as outlined below.

NR	Reference in act/bill/document	Comment (why is it a problem?)	Industry's proposed wording/comment	PA's proposed response
1.	Sub-regulation (6)(j) Table 1 Footnotes 2,3-page 23	The start of the phase-in period aligns with previous implementation dates that were amended by Guidance Note 3 of 2023.	**Recommendation:** Propose aligning with latest timelines as listed in G3-2023.	Agreed. Draft 2 of the Regulations has been amended to refer to 2024 and not 2023 and the specified risk weight to refer to 130% and 160% respectively and not 100%. The Regulations will be further updated to make provision for the 2025 implementation date- please refer to Draft 3 of the 5th set of proposed amendments to the Regulations relating to Banks for the updated phase-in period requirements. Banks must inform the PA of the decision to fully adopt on day 1, when relevant. If full adoption is on day 1, the full impact will be in 2025. Furthermore, please refer to the PA's response to comment 2 below, regarding transitional arrangements.

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2.	Proposed Regulation 23(6)(j)	1. If the 5-year linear phase-in begins in 2024: a. Will it be in January 2024? and b. When will the new forms be shared for testing of the rules and new risk weights for banks who will be risk weighting equity exposures using the linear phase-in arrangement? 2. If the banks are allowed to fully adopt on day 1: a. Will it be effective in 2024 (Prior to the implementation date of Basel III reforms on 1 July 2025, as per G3 of 2023). 3. Do banks then still need to risk weight equity exposures at the higher of the IRB approach and the phase-in arrangement or will the fully phased-in (standardised approach) then apply if Banks decide to fully adopt?	**To clarify:** We request confirmation of phase-in arrangements.	1. On the proposal to begin a 5-year linear phase-in in 2024: a. The commencement of the linear phase-in currently expressed in Draft 2 of the proposed amendments to the Regulations will be updated to align with the effective implementation date as expressed in G3/2023 (i.e. 1 July 2025). b. The proposed returns are being finalised and shall be published in Q3 2024, where further communication shall be provided regarding the testing environment and a parallel run submission period for the new template ahead of the effective implementation date. 2. In the case where banks are allowed to fully adopt on day one: a. Banks that currently apply the IRB approach for equity exposures are subject to a linear phase-

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				out of the IRB approach from the effective implementation date as expressed in G3/2023 to mitigate against a potential cliff effect in the regulatory reporting and capitalisation of such exposures from a sudden transition to the standardised approach. As such, during the IRB phase-out period, the risk weight for equity exposures will be the greater of: a. The current risk weight as calculated using the IRB approach that applied to such equity exposures prior to the effective implementation date; and b. the risk weight set for the linear phase-in arrangement under the standardised approach for credit risk. 3. Transitional arrangements:

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				Notwithstanding the aforesaid, the PA has the discretion to allow IRB banks to apply the fully phased-in standardised approach treatment from the effective implementation date of the regulatory framework (i.e. 1 July 2025). Banks may submit documentation to the PA providing substantiation for the decision not to apply the IRB phase-out period as well as an assessment of the implications thereof on regulatory capital, with the necessary internal governance approvals, for the PA's consideration.
3.	Amendments to Regulation 31 (Equity risk in the banking book)	A number of sections in regulation 31 are not applicable anymore.	**To clarify:** When will the amendments to regulation 31 as well as the new forms be distributed to banks?	The revisions, deletions and transitional arrangement considerations for Regulation 31 of the Regulations emanating from the Basel III post-crisis reforms including any revisions to the capital requirements for equity investments in funds (CREIF) framework as well as their effect on the associated regulatory return template (BA 340) are being finalised through internal governance

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				and policy processes and shall be circulated to industry through BASA in Q3 2024 for industry consultation, parallel run testing and readiness assessment prior to the effective implementation date of the framework.
4.	23(6)(j) Table 1 Submitted bilaterally	1. Our institution has noted amendments to equity exposure classifications, per Table 1 of regulation 23(6)(j) on page 122 of the draft 2 amendments, mainly introducing the speculative equity unlisted category (with an applicable risk weight of 400%) and other equity category (with an applicable risk weight of 250%) plus the 6% scalar. Regulation 31(6) specifies that a bank may apply the market-based approach to calculating equity risk exposures, provided that the internal ratings based (IRB) approach is applied in the bank's calculation of credit risk. Our institution calculates risk weight applicable to equity exposures under the simple risk weight method, applied under the market based approach, which specifies equity categories as either listed equity exposures (with an applicable risk weight of 300%) or unlisted equity exposures		1. With regards to the proposed amendments to the treatment of equity exposures: a. The revisions to the equity exposure categories and their associated risk weights (including the linear phase-in arrangements) as detailed in Regulation 23(6)(j) of the standardised approach to credit risk shall be appropriately cross-referenced in regulation 31 of the Regulations, where relevant. Please refer to Draft 3 of the 5th set of proposed amendments to the Regulations relating to Banks for the updated phase-in period requirements.

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		(with an applicable risk weight of 400%) plus the 6% scalar. With proposed amendments to the treatment of equity exposures (currently proposed under regulation 23), we seek clarity on the following: a. Can we can expect amendments to regulation 31 (such as the replacing of the "listed and unlisted" categories, with "speculative unlisted and other")? b. And can we expect amendments to the BA340 form, which discloses the above-mentioned equity categories under the market-based approach? c. The exact definitions on the investments that would qualify for the capital treatment under the legislated programme? d. If the amendments to regulation 31 are expected, would the extent be limited to the proposed changes from regulation 23 that impact regulation 31? Or would there be any other possible amendments that would impact regulation 31, such as		b. The new equity exposure categories detailed in regulation 23(6)(j) of the Regulations are applicable for exposures reported and capitalised under the standardised approach. The use of the market-based approach as well as all other IRB approaches for equity exposures will be phased-out as part of the linear phase-out arrangements. During the phase-out period the IRB equity exposure categorisations and their associated risk weights shall remain unchanged. As such, the standardised approach section of the form BA 340 shall be revised in accordance with the revisions in Regulation 23(6)(j) while the IRB approach section (which includes the market-based approach) shall remain unchanged.

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		investment in funds under regulation 31(7)? e. Will there be a proposed plan of implementation for the changes to equity risk in the banking book given the time required to engage with the industry through BASA given that most banks were not aware of the potential impact of this change? 2. Is there an expectation that 6% scalar will fall away from the IRB approach for credit risk (regulation 23), and consequently for equity risk (regulation 31).		c. Please refer to PA response previously provided for comment on legislated programmes during the industry consultative process for Draft 1: Annex 4 Draft 1 credit risk comments matrix.pdf (resbank.co.za) d. Refer to PA response to comment 3 above. e. Refer to PA response to comment 3 above. 2. With regards to the 6% scalar: During the linear phase-out of the IRB approach for equity exposures, IRB banks are expected to compare current equity exposure risk weightings that would apply under the IRB approach to those applicable during the standardised approach phase-in period and apply the higher of the two. IRB banks would still be expected to apply the scalar to their Equity Risk in the Banking

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				Book (ERIBB) exposures that are eligible for IRB reporting and capitalisation following the prescribed comparison conducted during the abovementioned linear phase-out of the IRB approach.